



*Michael C. Schlachter, CFA
Managing Director & Principal*

March 25, 2009

Mr. Joseph Dear
Chief Investment Officer
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

Re: Adoption of New Leverage Policy

Dear Joe,

You requested Wilshire's opinion with respect to Staff's proposed Policy on Leverage.

Recommendation

Wilshire recommends that the Policy Subcommittee approve the proposed leverage policy. As noted below, we believe that the Investment Committee should revisit this policy in a year to review the leverage calculations mandated by this policy and determine whether some sort of limit should be placed on the use of leverage across the entire investment portfolio.

Discussion

Leverage takes a great many forms within the CalPERS Investment Portfolio. Some asset classes, like Real Estate, make use of explicit leverage in virtually every investment, while others, like Global Equities, rarely employ leverage since some degree of leverage is already embedded in the financial structures of most of the underlying securities (Global Equity does have external 130/30 managers and an internal developmental long/short portfolio, which are levered). AIM uses leverage in every Buyout transaction but does not employ leverage in Venture Capital investments. Fixed Income transacts in a wide variety of investment types, employing leverage indirectly by investing in the debt of companies or governments, or through CDO or CLO securities, and directly through the use of Treasury futures or participation in the TALF program. Fixed Income's external managers can also invest in a 130/30 construct.

As a result, writing a single policy that controls leverage in every asset class is a difficult task and would contravene the recent efforts to simplify the overall policy manual by embedding leverage controls both at the Total Fund level and for each asset class or investment portfolio.

In our opinion, this policy, therefore, does not seek to control or limit leverage across the investment office. Rather, this policy sets guidelines for how leverage will be monitored and measured throughout the investment portfolio. In addition, this policy charges Staff with the responsibility for routinely reporting to the Investment Committee on the amount and types of leverage employed.

We believe that this policy will enable Staff and the Investment Committee to better understand and monitor the amount of leverage throughout the investment portfolio but we do not believe it will have any effect on the actual day-to-day management of assets, since all investment programs already have their own limits or prohibitions on leverage.

As noted in our recommendation, therefore, we believe that the Investment Committee should revisit this policy in a year or so. After the Investment Committee has seen a year's worth of leverage calculations and reporting, the Investment Committee should determine if the underlying leverage limits in each portfolio or program are sufficient or whether this policy should be expanded to set some kind of overarching leverage limit at the Total Fund level.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Schlachter", with a long horizontal flourish extending to the right.

Michael C. Schlachter, CFA